IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

No. 1145

IN THE MATTER

of

A. L. HARTRIDGE COMPANY INCORPORATED,

Bankrupt.

INDEMNITY INSURANCE COMPANY OF NORTH AMERICA,

Petitioner,

—against—

BAYARD I. REISLEY, as Trustee in Bankruptcy of A. L. HARTRIDGE COMPANY, INCORPORATED, Bankrupt,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

HENRY K. CHAPMAN,
Counsel for Petitioner.

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To the Honorable the Chief Justice and the Associate Justices of the United States:

Indemnity Insurance Company of North America, respectfully prays for a writ of certiorari to the Circuit

Court of Appeals for the Second Circuit, to review a decree of that court entered in the above entitled proceedings on December 3, 1945 (R. 29). A rehearing was denied by the Circuit Court on January 22, 1946. Said decree reversed in part an order of the District Court for the Southern District of New York dated July 14, 1945 (R. 5-6), which confirmed the order of the Referee in Bankruptcy dated April 24, 1945 (R. 12-13).

The first part of the Referee's order denied petitioner's application to vacate an order directing a 5% dividend to creditors. The order also denied petitioner's application to direct the trustee to pay to it $7,786.94. The second branch of the Referee's order denied the petition of the trustee for a reconsideration of a prior order (from which no review was ever sought) dated April 14, 1942 impressing a trust on funds in his hands in pursuance of the provisions of Section 36a of the Lien Law of the State of New York and directing the trustee to pay petitioner $5,263.40.

The opinions of the Circuit Court of Appeals for the Second Circuit have been reported in 153 F. (2d) 296. The opinions of the District Court and the Referee have not been reported.

Summary Statement of Matter Involved

The bankrupt corporation, a general building contractor, agreed to construct for W. T. Grant Company a building on land owned by Grant at Buffalo, N. Y. The agreement was made April 28, 1939, and the work completed July 1, 1940. The petitioner insured the bankrupt for workmen's compensation, public liability and general liability insurance in connection with the work on that building. Your petitioner secured a judgment in the sum of $13,-

050.34 for the premiums due from Hartridge on said job. On September 15, 1941, Hartridge was adjudicated a bankrupt on its voluntary petition (R. 14-15).

On January 26, 1942, Grant paid the trustee in bankruptcy $6,763.40 on account of that contract (R. 15).

On March 10, 1942, your petitioner filed a reclamation proceeding to recover from the trustee the amount paid to the trustee by Grant. On April 14, 1942, the Referee in Bankruptcy made an order adjudging said sum to be a trust fund to be applied to the payment of the claim of your petitioner and to creditors similarly situated as provided in Section 36a of the Lien Law of the State of New York. Said order directs the trustee to pay $5,263.40 to petitioner and to hold the balance of $1,500.00 subject to the further order of the Court. Pursuant to that order petitioner received $5,263.40 from the trustee (R. 15-16).

On September 29, 1943, a creditor of the bankrupt applied for reconsideration of the order of April 14, 1942, and for an order directing your petitioner to repay to the trustee the money theretofore collected upon the ground that it was paid under a mistake of law. The trustee in bankruptcy appeared and participated in the hearing and urged the granting of this application. The application was denied by an order dated November 8, 1943 (R. 16), and upon petition for review to the District Court an order was entered dated January 14, 1944, confirming the decision of the Referee. No appeal was taken from this order (R. 8).

On March 2, 1943, the trustee settled its account with Grant and received $17,085.62 in full payment of the construction contract (R. 16). On February 24, 1945, the Referee in Bankruptcy made an order directing the payment of a 5% dividend to general creditors (R. 5).

On March 6, 1945, your petitioner moved to vacate the order of February 24, 1945, and requested that the trustee be directed to pay to it the balance of $1,500.00 previously retained under the order of April 14, 1942, and also to pay it the sum of $6,286.94 out of the $17,085.62 received from Grant. The trustee filed an answer in opposition which included a cross-petition for reconsideration of the order of April 14, 1942, and upon such reconsideration for an order directing petitioner to repay to the trustee the amount paid to it under the order of April 14, 1942. The Referee denied petitioner's application and denied the application of the trustee for a reconsideration (R. 9). On July 14, 1945, on petition for review filed by both parties, the District Court affirmed the Referee (R. 5-6).

By its decision of December 3rd, 1945, the Circuit Court of Appeals for the Second Circuit sustained the District Court and the Referee in denying the petition of Indemnity Insurance Company and reversed the Court below in its denial of the Trustee's cross-petition for reconsideration and remanded the matter for further consideration (R. 27-28). The reversal was based upon the erroneous theory that the order of April 14, 1942, was open to reconsideration at any time before the estate was closed as provided by Section 57k of the Bankruptcy Act.

On rehearing the Circuit Court acknowledged its error but adhered to its original determination (R. 40-42).

The Questions Presented

The first three questions presented for decision by this Court concern themselves with the Referee's refusal to reconsider his order of April 14, 1942; the other two questions relate to the Referee's refusal to direct the trustee to pay petitioner the $7,786.94.

1. Assuming the challenged order of the Referee was erroneous, was it final, binding and impregnable to subsequent attack, since review or appeal was not sought or taken within the time limited by court rule or law?

2. Does an unexplained delay of almost three years constitute laches?

3. Has the adoption by the Supreme Court of the Rules of Civil Procedure for the District Courts of the United States made applicable in bankruptcy by General Order XXXVII modified the rule in *Wayne Gas Co.* v. *Owens-Illinois Glass Co.*, 300 U. S. 131, that a bankruptcy court may revise its judgments at any time during the pendency of the proceeding?

4. Is a trustee in bankruptcy justified in refusing to recognize the equitable rights of a beneficiary of a trust fund held by the trustee because he is protected by judicial immunity?

5. Can a trust relationship arise under the provisions of Section 36a of the Lien Law of the State of New York?

The Reasons for Allowing the Writ

1. The decision of the Circuit Court of Appeals in the instant case, which seems to be contrary to the overwhelming weight of authority, constitutes, it is submitted, a serious danger to the principle of certainty and finality of an order from which no appeal was taken within the specified time. The decision cannot even be justified by considerations of equity, since the petitioner, by the exercise of the diligence required by the rules, could have taken a timely appeal.

When the Referee denied respondent's application for a rehearing of the order made by him on April 14, 1942, he based his decision on the sole ground that he had denied a previous application in September, 1943 because it was untimely made (R. 16-17). Clearly this decision did not consider the merits of the original order of April 14, 1942. Consequently the Circuit Court erred in holding that the Referee had considered the order of April, 1942 on its merits.

2. The decision of the Circuit Court of Appeals, holding that the District Court and the Referee had clearly abused their discretion in refusing to re-examine the order of April 14, 1942, after an unexplained delay of three years is such a departure from the accepted and usual course of equity jurisprudence and such an interference with the authority vested in them as to call for a review by this Court.

3. This Court has not passed upon the effect of the Federal Rules of Civil Procedure upon its decision in the *Wayne Gas Company* case (*supra*). In the instant case the Circuit Court of Appeals for the Second Circuit relied upon this Court's decision in the *Wayne Gas Company* case (R. 41) in holding that the petition for rehearing was timely. This decision of the Circuit Court is not in harmony with the Circuit Court of Appeals for the Tenth Circuit which held that the Federal Rules of Civil Procedure superseded the procedure outlined in the *Wayne Gas Company* case.

A determination of this question is of importance in resolving the conflict between the Circuit Courts and in maintaining uniform administration of bankruptcy proceedings.

4. The Circuit Court of Appeals in sustaining the order of the District Court and the Referee in their refusal to direct the trustee to pay to petitioner, as beneficiary, the balance of the trust fund held by him violated established principles of equity and is contrary to its own decision in the case of *City of New York* v. *Rassner*, 127 F. (2d) 703.

5. The Courts below erroneously construed the decision of the Court of Appeals of the State of New York in the case of *Raymond Concrete Pile Co.* v. *Federation Bank & Trust Co.*, 288 N. Y. 452, in holding that Section 36a of the Lien Law of the State of New York can never give rise to a trust in favor of the beneficiaries designated therein. This is an erroneous interpretation of the State Court's decision. That Court clearly limited its decision to only one issue, namely, that Section 36a of the Lien Law and other similar sections did not provide a civil remedy for the enforcement of the trust created thereby but provided only for its enforcement by action in the criminal courts. The decision did not rule out the possibility of the creation of a trust under that section. That statute was enacted by the Legislature of the State of New York to cure certain evils which had caused heavy losses to materialmen, supplymen, laborers and others named in the section. Unless this erroneous construction of the state law is corrected by this court, it will adversely affect the construction industry. Beneficiaries of the trust arising under that statute will be deprived of their rights in the bankruptcy courts of the State of New York and of other states wherein similar statutes have been enacted. The present legislative policy of both the federal and state governments is to encourage the construction industry to meet the housing demand. The removal at this time of any protection afforded that industry would be contrary to that public policy.

PRAYER

For the foregoing reasons, which are developed in more detail in the accompanying brief, your petitioner prays that a writ of certiorari issue out of this Court to the United States Circuit Court of Appeals for the Second Circuit commanding said Court to certify and send this Court on a date to be designated, a full and complete transcript of the record and of all proceedings in the Circuit Court of Appeals had in this case, to the end that this case may be reviewed and determined by this Court; that the order and decision of the Circuit Court of Appeals be reversed; and that your petitioner be granted such other and further relief as may be proper.

INDEMNITY INSURANCE COMPANY OF NORTH AMERICA

By JAMES R. ROONEY

HENRY K. CHAPMAN,
Attorney for Petitioner,
291 Broadway,
New York, N, Y.

UNITED STATES OF AMERICA,
SOUTHERN DISTRICT OF NEW YORK, *ss.*:

JAMES R. ROONEY being duly sworn says: I am manager of the petitioner, a corporation organized under the laws of the State of Pennsylvania; and I have knowledge of this litigation. The foregoing petition and the matters therein set forth are true to the best of my knowledge, information and belief.

JAMES R. ROONEY

Certificate of Counsel

I certify that I have examined the foregoing petition, that in my opinion it is well founded and entitled to the favorable consideration of the Court and that it is not filed for the purpose of delay.

HENRY K. CHAPMAN

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BRIEF IN SUPPORT OF PETITION

Statement of the Case

A summary statement of the facts is given in the petition pages 2-4 above.

Grounds of Jurisdiction

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A. Sec. 347) and Section 24 (c) of the Bankruptcy Act.

Specification of Errors

The petitioner will urge that the Circuit Court of Appeals for the Second Circuit erred:

(1) In entertaining the appeal of the trustee from the decision of the District Court denying his application for a rehearing.

(2) In holding that the refusal of the District Court to grant the rehearing was an abuse of discretion.

(3) In holding that the Referee can revise an order in a reclamation proceeding at any time during the pendency of the bankruptcy proceedings.

(4) In sustaining the District Court and Referee in their refusal to direct the trustee to pay to petitioner, as beneficiary, the balance of the trust fund held by him.

(5) In sustaining the District Court that the decision of the Court of Appeals of the State of New York in the case of *Raymond Concrete Pile Co.* v. *Federation Bank & Trust Co.*, 288 N. Y. 452, ruled that Section 36a of the Lien Law of the State of New York can under no circumstances give rise to a trust in favor of the beneficiaries designated therein.

Statutes Involved

The statutes involved are set forth in the brief.

Opinions Below

The opinions of the Circuit Court are reported in 153 F. (2d) 296 and are contained in the record. The original opinion appears at (R. 24-28) and the opinion on the rehearing (R. 40-42).

POINT I

The Circuit Court of Appeals was without jurisdiction to entertain the trustee's appeal.

An order denying an untimely petition for rehearing because a prior similar petition for a rehearing was adjudged untimely does not constitute a reconsideration of the original order so as to extend the time for appeal therefrom.

The order which the trustee seeks to have reconsidered is dated April 14, 1942. Substantially, that order decreed that the monies collected by the trustee from Grant constituted a trust fund, as defined in Section 36a of the Lien Law of the State of New York, and the trustee was directed to pay to the petitioner the sum of $5,263.40. The referee made the following finding in connection with his denial of the trustee's application made in 1945:

"Conclusions of Law

1. The cross petition * * * by the trustee insofar as it prays for reconsideration and reversal of the order dated April 14, 1942 * * * must be denied on the ground that a previous application * * * to reconsider and set aside such order * * * has been denied and such decision is res adjudicata" (R. 17).

Obviously the merits of the order of April 14, 1942 were not considered. The referee simply determined that since an earlier application had been denied because it was untimely he refused to entertain a second application.

The decision of District Judge Rifkind confirming the referee's order states this very clearly:

"Even if I assume that I am not bound by the decision of Judge Mandelbaum, from which no review by the Court of Appeals has been sought, and that the doctrine of res adjudicata does not apply, nevertheless, it would seem clear that an application which was tardy in September, 1943, cannot have become timely on March 8, 1945, when the trustee's cross petition was filed" (R. 8).

In the case of *Bernards* v. *Johnson,* 314 U. S. 19, 31, on facts almost identical to the present case this Court held:

"The Court dismissed the petition for review. The commissioner had denied the petition of January 4, 1937, on the sole ground 'that all the matters and things set out in said petition have been previously adjudicated and no review thereof has been had, or if review was taken, such actions of the Referee have been approved on review', and that 'all matters and things in said petition alleged have heretofore been considered upon petition filed by said bankrupts and decided adversely to said bankrupts, and said orders have all become final and conclusive.' The order affirming the action of the commissioner did not deal with the merits. The Court clearly affirmed the commissioner's refusal to consider the petition for the reason stated by him.

In dismissing the petition of January 15, 1937, and the motion of April 13, 1938, the Court made findings of fact and stated conclusions of law covering both. It entered what it denominated an 'order and decree' with respect to both, and, as above noted, dismissed both the petition and the motion, on the stated ground that all issues therein raised had been finally adju-

dicated and no review or appeal had been timely sought or taken.

If the respondents had not cross-petitioned for affirmative relief, the District Court need have taken no further action than it did in dismissing the bankrupts' petition and motion. An order denying a petition for rehearing or review, which is dismissed because the petition was filed out of time, without reconsideration of the merits, does not extend the time for appeal from the original order."

Nor does an examination of the grounds for allowing a rehearing enlarge the time for review of the original order. *Pfister* v. *Northern Illinois Finance Corp.*, 317 U. S. 144, 151. There the Court stated:

"On the other hand, where out of time petitions for rehearing are filed and the referee or court merely considers whether the petition sets out, and the facts—if any are offered—support, grounds for opening the original order and determines that no grounds for a re-examination of the original order are shown, the hearing upon or examination of the grounds for allowing a rehearing does not enlarge the time for review of the original order. This result follows from the well-established rule that where an untimely petition for rehearing is filed which is not entertained or considered on its merits the time to appeal from the original order is not extended.

If a consideration of the reasons for allowing a rehearing out of time which are brought forward by the petition for rehearing were sufficient to resurrect the original order, the mere filing of an out of time petition would be enough. Of course, the court must examine the petition to see whether it should be grant-

ed. Indeed the examination given a motion to file such a petition might just as well be said to justify the advancement of the time for review. It is quite true that in a petition for review upon the ground of error in law in the original order, the examination of the grounds of the petition for rehearing is equivalent to a re-examination of this basis of the original decree. But in such a case the order on the petition for review would control. It would show either a refusal to allow the petition for rehearing or a refusal to modify the original order. Cf. *Wayne Gas Co.* v. *Owens-Illinois Co.*, 300 U. S. 131, 137-38. Whether time for appeal would be enlarged or not would depend upon what the order showed the Court did."

POINT II

Equity will not aid one who has slept upon his rights and shows no excuse for his delay.

The trustee seeks reconsideration of an order made on April 14, 1942. The trustee not only did not seek a review by the District Court of the said order but complied with it. No action whatever was taken by the trustee until September 29, 1943 when a creditor of the bankrupt made an application for reconsideration of the said order on the ground of mistake of law. The basis of the said petition was the decision by the Court of Appeals of the State of New York in the case of *Raymond Concrete Pile Co.* v. *Federation Bank & Trust Co.*, 288 N. Y. 452, 43 N. E. (2d) 486 decided July 29, 1942. The trustee appeared and participated in the hearing based upon the creditor's application and urged the vacatur of the order of April 14, 1942 (R. 16). Upon the denial of the creditor's application by

the Referee a review of the said order was taken to the District Court and on January 14, 1944 the District Court confirmed the Referee. No appeal was taken from that order.

On March 6, 1945 the petitioner made an application to the Referee to vacate an order providing for the payment of a 5% dividend to general creditors and asked for a direction to the trustee that he pay to the petitioner the balance of its claim to the trust funds in his possession. It was not until March, 1945, almost three years after the entry of the original order, in the answer to the petition of March 6, 1945, that the trustee sought a rehearing of the order of April 14, 1942, by interposing a cross-petition to the application made by the insurance company.

The facts in the case of *Price* v. *National Surety Corporation*, 127 F. (2d) 726 were closely akin to the instant case. Holding that a delay of slightly less than two years bars a review of the order appealed from, the Circuit Court of Appeals for the Sixth Circuit in a *per curiam* decision said:

> "This cause was heard on the transcript of the record and briefs of counsel, and on consideration thereof no reversible error appears on the record. Assuming without deciding, that a bill of review is the proper remedy for the relief sought, the court is of the opinion that, under the circumstances in this case, the delay in filing it, from May 18, 1938, to March 18, 1940, showed a lack of due diligence."

Petition for certiorari denied. 316 U. S. 683.

The authorities to support that conclusion are numerous and decisive.

POINT III

The adoption by the Supreme Court of the Rules of Civil Procedure which were made applicable in bankruptcy by General Order XXXVII modified the Rule in the *Wayne Gas Co.* case that a bankruptcy court may revise its judgments at any time during the pendency of the proceedings.

The contention of petitioner is that in a reclamation proceeding, which is in the nature of a civil suit, reconsideration of a final order is governed by Rules 59 and 60. It is true that due to the nature of the grounds upon which the trustee is seeking to have the original order reconsidered he is not entitled to the relief afforded by Section 60. He could have obtained relief under Section 59 had he applied within the time prescribed by that section.

In disregarding the effect of the Rules of Civil Procedure on applications for rehearings, the Circuit Court of Appeals in the instant case is directly in conflict with the Circuit Court of Appeals for the Tenth Circuit. The latter Circuit Court, in the case of *Norris* v. *Camp* (1944), 144 F. (2d) 1, 4, said:

> "Prior to the effective date of General Order No. 37, 11 U. S. C. A. following section 53, a court of bankruptcy had the power, for good reason, to revise its judgments upon seasonable application and before rights had vested on the faith of its action (citing the Wayne United Gas Co. and others). But General Order No. 37 made the Rules of Civil Procedure applicable to proceedings in bankruptcy. Rule 60 (b) of the Rules of Civil Procedure, in part, provides: (quoting Section 60 (b)).

> Since the six months' period had expired before the answer was filed by the city treasurer, we think the lower court had no power to modify the order and final judgment in the composition proceeding under the provisions of Rule 60. This rule, however, does not limit the power of the court to entertain an action to relieve a party from a judgment, order or proceeding. But, after the expiration of six months, the party must apply by bill of review, now designated civil action, to obtain relief from a judgment which itself is final so far as any further steps in the original action are concerned."

Apparently this question was not passed upon by this Court. In the 1945 supplement to Vol. 2, 4th edition of Remington on Bankruptcy there is the following query:

> "Has Federal Rules of Civil Procedure 60 (b) made applicable by General Order XXXVII modified the rule in Wayne United Gas Co. v. Owens-Illinois Gas Co., 300 U. S. 131, 81 L. ed. 557, 57 S. Ct. 382, 33 A. B. R. (N. S.) 1 (1937) that a bankruptcy court may at any time for good reason on seasonable application and before rights have vested revise its judgments?"

The original order of the referee dated April 14, 1942 was not interlocutory but final and appealable. It was a complete and definitive disposition of the cause before the Court. The only provisions in the Rules for the modification or vacation of such an order are found in Rules 59 and 60. The latter is clearly inapplicable. A change in the law by a subsequent decision is neither a clerical mistake nor a mistake of a party. Under the old equity procedure the bill of review served substantially the same

purpose after term as the petition for rehearing served during term and consequently would not lie until the time for filing a petition for rehearing at best. But the grounds that would sustain a bill of review were more limited than those that would sustain a petition for rehearing. Thus a subsequent decision of a higher court changing the law would lay the foundation for a petition for a rehearing but not for a bill of review. Since such a subsequent decision is precisely the ground of the trustee's application, it follows that it cannot be treated as a bill of review. Therefore the present application must be considered as addressed to the exercise of the power of the court under Rule 59.

Rule 6 (c) now abolishes the effect of the expiration of the term on the power of the Court to act. Rule 59 (b) provides a definite time within which a motion for a new trial may be made and Rule 6 (b) forbids the Court to enlarge that time. If it were not thereby intended to make the running of that definite time as conclusive on the power of the Court as was formerly the expiration of the term, there would be no limit on the power of the Court to act and no finality when it did act. A construction which would empower the Court to hear motions long out of time would destroy the rule for by the very act of hearing, the prohibited relief could effectively be granted.

POINT IV

The trustee in bankruptcy cannot refuse to recognize the trust rights of the petitioner because he is protected by judicial immunity from the penal consequences of his acts.

After the decision by the New York Court of Appeals in the *Raymond Concrete* case the only method left for the enforcement of the trust established by that section was recourse to the criminal courts. The funds came into the hands of the trustee after the adjudication and he is protected by his office from the criminal penalties prescribed by that section. The Circuit Court of Appeals for the Second Circuit in a case similar to the present case declared that the trustee would not be permitted to take advantage of his immunity to deprive the beneficiary of a trust of its avails. In the case of *City of New York* v. *Rassner*, 127 F. (2d) 703, the Court stated:

> "If the debtor in possession failed to segregate the taxes collected from vendees, it did so under the control of the court. The city could hardly seek fine or imprisonment of the debtor or its officers for failure to segregate funds—assuming the penal provisions, Administrative Code C 41 Lib N Sec 41-17.0, as amended by Local Laws 1940, p. 362, go that far—because the status of the debtor as under court control would be a defense.
>
> Thus stated, it can be seen that we would be condoning improper action by a trustee so long as he could successfully get away with it. As a court of equity, a bankruptcy court can hardly proceed on this assumption."

The decision of the Circuit Court of Appeals in the present case seems to conflict with its prior decision in the above cited case. The Court should have applied the same rule to the instant case.

POINT V

The Courts below in holding that Section 36a of the Lien Law of the State of New York can never give rise to a trust in favor of the beneficiaries designated therein misconstrued the decision of the Court of Appeals of the State of New York in the case of *Raymond Concrete Pile Co.* v. *Federation Bank & Trust Co.*

A reading of Section 36-a[1] clearly shows that first a right is created; that is, the funds received by a contractor or an owner for the improvement of real property is declared to constitute a trust fund for the benefit of the persons named, and then the section goes on to provide a remedy to enforce compliance therewith.

In the case of *Raymond Concrete Pile Co.* v. *Federation Bank & Trust Company,* 288 N. Y. 452, the plaintiff, a sub-

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1 Section 36-a of the Lien Law of the State of New York prior to the 1942 amendment, provided as follows:

> "The funds received by a contractor from an owner for the improvement of real property are hereby declared to constitute trust funds in the hands of such contractor to be applied first to the payment of claims of subcontractors, architects, engineers, surveyors, laborers and materialmen arising out of the improvement, and to the payment of premiums on surety bond or bonds filed and premiums on insurance accruing during the making of the improvement and any contractor and any officer, director or agent of any contractor who applies or consents to the application of such funds for any other purpose and fails to pay the claims hereinbefore mentioned is guilty of larceny and punishable as provided in section thirteen hundred and two of the penal law."

contractor of a general contractor who was a depositor in the defendant bank, brought a civil suit against the bank to recover from it certain money which the bank had applied on a loan made by it to the contractor on the ground that the money so applied constituted a trust fund for its benefit.

The Court of Appeals reversed the decision of the Appellate Division in favor of the plaintiff and dismissed the complaint. In the course of its opinion, the Court held that Section 36-a of the Lien Law did not create a civil remedy to enforce the trust set up therein. The Court, in its opinion, clearly accepted the trust fund theory created by the statute and directed its opinion solely to the means of enforcement of the right, holding that no new civil remedy was given. Whether a trust arises depends on the facts and circumstances in each particular case. The Court said:

> "* * * Whether the monies in the hands of the contractor are or may be the subject-matter of a trust depends exclusively upon the fact, arising, existing and shifting according to time and circumstance, that the contractor fails to pay the claims mentioned in the section * * *"

The 1942 amendment made the following changes: It added to the catch line "Civil remedy to enforce trust" and at the end of the section the following was added:

> "Such trust may be enforced by civil action maintained as provided in article three-a of this chapter by any person entitled to share in the fund, whether or not he shall have filed, or had the right to file, a notice of lien or shall have recovered a judgment for a claim in connection with the improvement. For the purposes of a civil action only, the trust funds shall include the right of action upon a building loan contract, mortgage or conveyance for moneys due or to become due thereunder to the owner, as well as moneys actually received by him."

The amendment is contained in Chapter 808, Section 2 of the Laws of 1942, effective September 1, 1942.

"* * * It necessarily follows that no trust arises under that section from the mere fact that the contractor received and has in his hands monies in payment on account of a public improvement."

It is therefore apparent that the decision of the Court of Appeals in the *Raymond Concrete* case does not alter the trust nature of the fund received from Grant and does not deprive the petitioner of its rights as a beneficiary thereof upon distribution in bankruptcy.

Section 1302 of the Penal Law[2] deals with the punishment of fiduciaries for converting or misappropriating

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2 Section 1302 of the Penal Law of the State of New York reads as follows:

"Conversion of property held in trust or by virtue of office, larceny; how punished

A person acting as executor, administrator, committee, guardian, receiver, collector or trustee of any description, appointed by a deed, will, or other instrument, or by an order or judgment of a court or officer, who secretes, withholds, or otherwise appropriates to his own use, or that of any person other than the true owner, or person entitled thereto, any money, goods, thing in action, security, evidence of debt or of property, or other valuable thing, or any proceeds thereof, in his possession or custody by virtue of his office, employment, or appointment, is guilty of grand or petit larceny in such degree as is herein prescribed, with reference to the amount of such property; and upon conviction, in addition to the punishment in this article prescribed for such larceny, may be adjudged to pay a fine, not exceeding the value of the property so misappropriated or stolen, with interest thereon from the time of the misappropriation, withholding, or concealment, and twenty per centum thereupon, in addition, and to be imprisoned for not more than five years in addition to the term of his sentence for larceny, according to this article, unless the fine is sooner paid.

So much of the fine authorized in this section to be imposed, as does not exceed the amount or value of the property taken, appropriated, or stolen, with interest thereupon from the time of the commission of the offense, and a reasonable sum to defray the expense of collecting the same, to be fixed by the supreme court, must, when received or collected, be paid to the county treasurer of the county where the conviction was had, for the benefit of the person injured or defrauded, or whose property the offender took, misappropriated, or concealed, or his representative or assignee; and must be paid over to him by the county treasurer, upon the order of the supreme court, made after notice to the district attorney of the county."

property belonging to a trust. If the trust theory upon which the entire Section 36a is founded is destroyed, it is difficult to see how enforcement under the penal provisions could be sustained. This would render the entire legislation negatory. It is apparent that the Court of Appeals never intended to go that far.

CONCLUSION

It is respectfully submitted that the petition for certiorari should be granted.

HENRY K. CHAPMAN,
Counsel for Petitioner.

Dated: April 19th, 1946.

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BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

No. 1145.

IN THE MATTER

of

A. L. HARTRIDGE COMPANY INCORPORATED,
Bankrupt,

INDEMNITY INSURANCE COMPANY OF NORTH AMERICA,
Petitioner,

against

BAYARD L. REISLEY, as Trustee in Bankruptcy of A. L. Hartridge Company Incorporated, Bankrupt,
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

Summary of Argument.

The Trustee's application for reconsideration of the order of April 14, 1942 and for the return of the money paid pursuant to that order, was timely. No principle of Bankruptcy Law is more firmly established than that a Bankruptcy Court may rehear any matter and vacate and modify its orders at any time before the Estate is closed and before rights have vested. The time limitations of Rules 59 and

60 of the Federal Rules of Civil Procedure are not applicable to orders in bankruptcy during the pendency of the bankruptcy proceeding. *There is no conflict in the decisions on this point.*

The Circuit Court of Appeals unquestionably had the *power* to entertain the Trustee's appeal, whether considered as an appeal from an order denying reconsideration or from an order denying an untimely petition to review.

The Trustee opposed the petitioners trust claim because of controlling decisions of the New York Court of Appeals. The Circuit Court of Appeals in upholding the Trustee in this respect *is squarely in accord with the only other decision of a Circuit Court of Appeals involving the identical question.* Moreover the question whether Section 36(a) of the New York Lien Law *now* creates a civil trust right can never arise as it has been disposed of in Amendments to the New York Lien Law effective September 1, 1942. *Hence no public interest or public policy is involved in the instant case.*

POINT I.

The Trustee's application for reconsideration was timely and was not barred by the time limitations of the Rules of Civil Procedure.

It is a firmly established rule of bankruptcy that a Bankruptcy Court has the right to rehear any matter and vacate or modify its orders at any time before the Estate is closed and before rights have vested. This Court so stated in the case of *Wayne Gas Co.* v. *Owens-Illinois Co.*, 300 U. S. 131.

The principle was restated by this Court in *Pfister* v. *Northern Illinois Finance Corp.*, 317 U. S. 144 (November

1942) a case after the effective date of the Rules of Civil Procedure and the Revised General Orders in Bankruptcy;[1] at page 149:

> "Where a petition for rehearing of a referee's order is permitted to be filed, after the expiration of the time for a petition for review, *and during the pendency of the bankruptcy proceedings,* as here, they may be granted 'before rights have vested on the faith of the action,' and the foundations of the original order may be re-examined. *Wayne Gas Co.* v. *Owens-Illinois Co.*, 300 U. S. 131, 137." (Italics ours).

The principle was followed in the case of *In re Morris,* 152 F. 2d 178, (C. C. A. 7, December 1945) where the Court upheld the right of the District Court to vacate in February 1945, orders which had been made in May and December 1941.

The reason for not applying the time limitations of the Rules of Civil Procedure to Bankruptcy Proceedings, may be found in the proposition that they do not apply to interlocutory orders or judgments and that all orders in bankruptcy are interlocutory until the estate is closed. *In re Chicago, M., St. P. & P. R. Co.,* 138 F. 2d 235 (C. C. A. 7, 1943; cert. den. 321 U. S. 770).

> "Since the proceedings and orders of a bankruptcy court are interlocutory until entry of the discharge, *Meyer* v. *Kenmore, etc., Co.*, 297 U. S. 160, 56 S. Ct. 405, 80 L. Ed. 557; *Shulman* v. *Wilson, etc., Co.*, 301 U. S. 172, 57 S. Ct. 680, 81 L. Ed. 986; *American United L. Ins. Co.* v. *Haines City,* 5 Cir., 117 F. 2d 574, and may be modified and rescinded before final decree, *Simmons Co.* v. *Grier Bros. Co.*, 258

[1] The Revised General Orders became effective February 13, 1939.

U. S. 82, 42 S. Ct. 196, 66 L. Ed. 475, if no intervening rights will be prejudiced, the court may grant a rehearing, *Wayne Gas Co.* v. *Owens-Illinois Glass Co.*, 300 U. S. 131, 137, 57 S. Ct. 382, 81 L. Ed. 557."

American United Life Insurance Co. v. *Haines City Florida*, 117 F. 2d 574 (C. C. A. 5, 1941), at page 575:

> "We do not think, as appellant contends, the judgment confirming a plan is necessarily unalterable after ten days. Although it is by the statute made appealable, 11 U. S. C. A. §403, sub. e, it is in the same sentence and in several other places, called interlocutory. Like other interlocutory judgments it remains in a measure in the Court's control if not appealed from. Though the Rules of Civil Procedure, 28 U. S. C. A. following section 723c, have by General Order in Bankruptcy 37, 11 U. S. C. A. following section 53, been made generally applicable to bankruptcy proceedings, the provisions of Rule 59 and 60 limiting the time for new trials and some other forms of review do not render interlocutory judgments final."

The oft cited case of *Simmons Co.* v. *Grier Bros. Co.*, 258 U. S. 82 where this Court upheld the right to rehear a determination with respect to the validity of a patent, made by interlocutory decree, although some three years had elapsed, was followed by this Court after the effective date of the Rules of Civil Procedure, in the case of *Marconi Wireless Co.* v. *United States*, 320 U. S. 1 (June 1943); at page 47:

> "Although the interlocutory decision of the Court of Claims on the question of validity and infringement was appealable, *United States* v. *Esnault-Pelterie*, 299 U. S. 201, 303 U. S. 26; 28 U. S. C. §288 (b), as are interlocutory orders of district courts in suits to enjoin infringement, 28 U. S. C. §227(a);

Simmons Co. v. *Grier Bros. Co.*, 258 U. S. 82, 89, the decision was not final until the conclusion of the accounting. *Barnard* v. *Gibson*, 7 How. 649; *Humiston* v. *Stainthrop*, 2 Wall. 106; *Simmons* v. *Grier Bros. Co., supra*, 89. Hence the court did not lack power at any time prior to entry of its final judgment at the close of the accounting to reconsider any portion of its decision and reopen any part of the case. *Perkins* v. *Fourniquet*, 6 How. 206, 208; *McGourkey* v. *Toledo & Ohio Central Ry. Co.* 146 U. S. 536, 544; *Simmons Co.* v. *Grier Bros. Co., supra*, 90-91."

The case of *Norris* v. *Camp*, 144 F. 2d 1, cited at page 18 of Petitioner's brief, involved an application to modify an order in bankruptcy, *some four years after the final decree had been entered and the estate closed.* Whether or not the time limitations contained in the Rules of Civil Procedure might bar relief in such a case has no bearing upon a case where application for relief is made *during the pendency of the bankruptcy proceeding.*

With respect to petitioner's contention that the Trustee was guilty of laches in applying for reconsideration, it should be noted that the application was based upon the ground that the Referee in making the order of April 14, 1942 had erroneously construed Section 36(a) of the New York Lien Law. This error did not become fully apparent until the decision of the New York Court of Appeals in the case of *New York Trap Rock Corporaton* v. *National Bank of Far Rockaway*, 293 N. Y. 884, a case relied upon by all of the Courts below (R. 27, 7, 20). However, that case was not decided until January 1945 and it was not until March 1945 that an application for rehearing was denied (294 N. Y. 691). It was in March 1945 that the Trustee made his application for reconsideration. Certainly that application

was timely. Indeed an earlier application might well have been premature.

It should also be noted that under the lower Court's decree of reversal the matter is remanded for determination as to whether Petitioner has changed its position since it received the $5,263.40 pursuant to the order April 14, 1942 (R. 27). Hence Petitioner is protected against damage by reason of the lapse of time.

POINT II.

The Circuit Court of Appeals unquestionably had jurisdiction of the Trustee's appeal.

The question which petitioner raises in his Point I, as to whether the Referee upon the application for rehearing, considered the order of April 14, 1942, on the merits, so as to extend the time to review, need not be argued in order to sustain the jurisdiction of the Appellate Court. Jurisdiction can be sustained either by considering the appeal as one from an order denying rehearing or from an order denying an untimely petition to review.

Regardless of language which appears in some cases, an order denying a motion for rehearing or reconsideration for mistake of law is subject to review (*Fairmount Glass Works* v. *Coal Co.*, 287 U. S. 474; *Wharton* v. *Farmers and Merchants Bank*, 119 F. 2d 487, C. C. A. 8). Indeed an order denying any motion for reconsideration or rehearing is subject to review for abuse of discretion. (*U. S.* v. *Socony-Vacuum Oil Co.*, 310 U. S. 150, 247; *Patton* v. *Lewis*, 146 F. 2d 544, 545, C. C. A. 10; *Powell* v. *Wumkes*, 142 F. 2d 4, C. C. A. 9; *Kimm* v. *Cox*, 130 F. 2d 721, 732, C. C. A. 8; *Rafert* v. *Equitable Life Assurance Society*, 138 F. 2d 185, 187, C. C. A 8, cert. den. 320 U. S. 801). The

Circuit Court of Appeals found an abuse of discretion in the instant case.

In any event the power to review is clearly sustained by the decision of this Court in *Pfister* v. *Northern Illinois Finance Corp.*, 317 U. S. 144. In that case, as in the instant case, a petition for rehearing of an order in bankruptcy had been filed after expiration of the ten-day period for filing a petition to review. This Court held that while the filing of the petition for rehearing did not extend the ten-day period, the Court nevertheless had the *power* to review the order, a rehearing of which was sought; at pages 147, 151, 153:

> "The Court of Appeals affirmed the judgment on the grounds that 39(c) governed, that the time for review was not extended by the petitions for rehearing, that there was no basis for reversing the Commissioner's action on the petitions for review, and that the 'petitions for review were not filed in time.' We disagree with the Court of Appeals upon the last ground on the assumption that the language meant that the District Court was without 'power' to review the orders. * * *
>
> "Since the petitions for rehearing, in our opinion, did not extend the time for review, we are brought to examine the question as to whether §39(c), *supra*, note 2, is a limitation on the power of the District Court to act or on the right of a party to seek review. Courts of bankruptcy are courts of equity without terms. Commissioners, like referees, masters and receivers, supervise estates under the eyes of the court with their orders subject to its review. The entire process of rehabilitation, reorganization or liquidation is open to re-examination out of time by the District Court, in its discretion, and subject to intervening rights. Cf. *Wayne Gas Co.* v. *Owens-*

Illinois Co., 300 U. S. 131, 137; *Bowman* v. *Loperena*, 311 U. S. 262, 266. * * *

"The power in the bankruptcy court to review orders of the referee is unqualifiedly given in §2(10). The language quoted from §39(c) is rather a limitation on the 'person aggrieved' to file such a petition as a matter of right."

POINT III.

The lower courts correctly upheld the Trustee in opposing petitioner's trust claim under controlling decisions of the New York Court of Appeals.

The Trustee opposed petitioner's trust claim because of controlling decisions of the New York Court of Appeals which denied the existence of any such trust and not because of any judicial immunity from the penal consequences of his acts (Petitioner's Point IV). The case of *City of New York* v. *Rassner*, 127 F. 2d 703, cited at page 21 of petitioner's brief, involved the provision of the New York City Sales Tax Law which required the tax to be "paid by the purchaser to the vendor as trustee for and on account of the City". There was no question as to whether the State Statute made the vendor a trustee. The only question was as to whether the admitted trust right should take precedence over other administration expenses.

In our case the New York Court of Appeals has squarely held that Section 36-a of the New York Lien Law as in effect prior to the Amendments effective September 1, 1942, created no civil trust right. Whatever doubt may have existed from the decision in the case of *Raymond Concrete Pile Co.* v. *Federation Bank & Trust Company*, 288 N. Y. 452, has been finally resolved by subsequent decisions of the New York Court of Appeals. Petitioner does not even

refer to these subsequent decisions although they were relied upon by the lower courts.

In the case of *Raymond Concrete Pile Co.*, 288 N. Y. 452, decided July, 1942, a trust was claimed on behalf of unpaid materialmen in money received by a contractor for an improvement, deposited in the defendant bank and applied by the bank in payment of an obligation owed to it by the contractor, the bank having no knowledge that there were any unpaid materialmen or subcontractors. The Court of Appeals dismissed the complaint in an opinion which concluded as follows, at page 463:

> "In the only case in which the question was raised in this Court, we held that an individual claimant could not maintain an action under Section 25-a (*New York Trap Rock Corporation* v. *National Bank of Far Rockaway,* 285 N. Y. 825). We must now conclude that no civil representative action is created by that section and that it does nothing more than to bring an offender under that section within the coverage of Section 1302 of the Penal law."[2]

Reargument was granted and the original decision adhered to by the Court of Appeals in March, 1943 (290 N. Y. 611).

Despite the opinion quoted above, lower court decisions differed in cases where the bank or other party had knowledge of the claims of unpaid materialmen and unpaid subcontractors (compare *Saltser & Weinsier Inc.* v. *Monroe Plumbing & Heating Supply Corp.*, 265 App. Div. 821, 2nd Dept., with *New York Trap Rock Corp.* v. *National Bank of Far Rockaway,* 265 App. Div. 994, 1st Dept.) All doubts were set to rest by the Court of Appeals in the case of *New*

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[2] Section 25-a of the Lien Law is identical with Section 36-a except that the former deals with public improvements and the latter deals with private improvements.

York Trap Rock Corporation v. *National Bank of Far Rockaway,* 293 N. Y. 884 (decided January, 1945; reargument denied March, 1945, 294 N. Y. 691). That was a representative action by unpaid materialmen claiming a trust under the New York Lien Law in money received by a contractor for an improvement and paid to the defendant Bank in payment of the contractor's debt to it. The record shows that the bank had notice of the claimed trust at the time it received the money (First Department Records, Vol. 8240, pp. 12, 17 and 49). The Court of Appeals held as follows:

> "Judgment reversed and complaint dismissed with costs of all courts, on the authority of *Raymond Concrete Pile Co.* v. *Federal Bank,* 288 N. Y. 452."

This decision was foreshadowed by the decision in the case of *Saltser & Weinsier Inc.* v. *Monroe Plumbing & Heating Supply Corporation,* 290 N. Y. 903, decided June 18, 1943. There a trust was claimed by an unpaid materialman, in money received by a contractor for an improvement. The defendant claimed the money under an assignment made by the contractor in consideration of a debt owed by the contractor to defendant for work done on a construction job different from that for which the money had been paid to the contractor. The trust was asserted both under the Lien Law and by virtue of an express promise made by the contractor. Attorneys for the respective claimants held the money in escrow pending the outcome of the litigation. The materialman argued in the Court of Appeals that Section 36-a of the Lien Law created a trust of which it was a beneficiary and that the 1942 amendments to the Lien Law specifically authorizing a civil action were merely declaratory of pre-existing law. It was argued in opposition that Section 36-a of the Lien Law created no civil rights, citing

the *Raymond Concrete Pile Co.* decision. The Court of Appeals affirmed without opinion the judgment dismissing the complaint.

The Circuit Court of Appeals in sustaining the Trustee in the instant case is squarely in accord with the decision in *In re Edward Misch Co.'s Estate,* decided by the Federal District Court in Michigan, 34 F. Supp. 781 and affirmed on the opinion of the District Judge by the Circuit Court of Appeals for the Sixth Circuit, 112 F. (2d) 1007, a case ignored by Petitioner in its brief although cited by the Referee in his opinion. In that case a claimant in bankruptcy made application to have money in the hands of a bankruptcy trustee declared a trust fund for the benefit of a claimant materialman and others, the Michigan statute containing trust provisions similar to those found in the New York Lien Law as it existed prior to 1942. The District Court affirmed the order of the Referee, which had denied the relief requested, for the reason that the Supreme Court of Michigan had construed the statute as being penal in nature and not affording civil rights. At page 782:

> "Petitioner's contention that Act 259 of Michigan Public Acts of 1931 affords it the right to claim money in the custody of the Trustee, under the facts in this case presents solely a question of law. It appears to this Court that the construction placed upon the statute in question by the Michigan Supreme Court in the case of Club Holding Company *v.* Flint Citizens' Loan & Investment Company reported in 272 Mich. 66, 261 N. W. 133 is conclusive upon the question. In passing upon a State statute, this Court is constrained to give effect to the same in harmony with the decisions of the court of last resort of such State.
>
> The Michigan Court holds that the statute is a penal statute and as such, does not affect the civil

rights and obligations of the classes of persons mentioned therein.

The alleged right of petitioner involved in this controversy is solely a claimed civil right.

It therefore follows that the construction placed on this statute by the Michigan Court is too plain for further argument, and that an order may be entered herein confirming the Referee's order."

This decision was affirmed by the Circuit Court of Appeals on the opinion of the District Judge (112 F. 2d 1007).

Whether the New York Lien Law *now* creates a civil trust right has been settled by the New York State Legislature in its Amendment to the Lien Law effective September 1, 1942 (See page 23, Petitioner's brief). These amendments provide, as to improvements completed subsequent to September 1, 1942, a civil trust right which would be enforceable in bankruptcy or otherwise. We are at a loss to understand how Petitioner could make the statement, at page 7 of its petition, that the decision in the instant case "will adversely affect the construction industry". *In view of the amendments to the Lien Law, the question at issue can never arise again.*

Conclusion.

It is respectfully submitted that the petition for certiorari should be denied.

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